WELLS FARGO

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By Facsimile and Courier
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Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Ms. Jennifer J. Johnson
Secretary

Re: Regulation CC; Docket No. R-1176

Dear **Governors:**

Wells Fargo & Company ('Wells Fargo") is a diversified Financial services company providing banking, insurance, investments, mortgage, and consumer finance through over 5,900+ banking facilities, the Internet ("wellsfargo.com"), and other distribution channels throughout North America, including all 50 states, and the international marketplace. Wells Fargo has $388 billion in assets and 144,000 employees. **Wells Fargo** is one of the **United** States' top-40 **largest** employers. Wells Fargo ranked fifth in assets and third in market **value** of its stock at December 31,2003, among its peers.

This comment **letter is** submitted on behalf of Wells **Fargo** in **response** to the request **by the Board** of **Governors** of the Federal Reserve System (the "Board") for comment contained in the proposal (the "Proposal") to amend Regulation CC,[1] by adding a **new** subpart D, **with**

[1] 12 C.F.R. Part 229.

commentary, for the purpose of implementing the recently enacted Check Clearing for the 21st Century Act (the "Act").[2]

Wells Fargo is a member of the Electronic Check Clearing House Organization ("ECCHO"), a not-for-profit national clearing house dedicated to promoting electronic check collection and related payment system improvements. By separate cover, ECCHO is submitting comment letters through an operations subcommittee and through a group of financial services industry organizations and technology companies. Wells Fargo has assumed an active role in the preparation of these letters and hereby confirms its support therefor,

I. Background to the Proposal, Under Docket No, **R-1176,** the **Board** proposes amendments to Regulation CC by adopting a **new subpart** D. These proposed amendments (1) **would** set forth the requirements of the Act applying to banks; **(2)** provide a model **consumer** disclosure and model consumer notices relating to substitute checks; **and (3)** set **forth** indorsement requirements **and** truncating bank **and** reconverting **bank** identification requirements for substitute checks. The Proposal also would clarify some existing **provisions** of Regulation CC **and** its commentary. Finally, the **Board** seeks comments on whether it **would be** appropriate to incorporate the proposed Uniform Commercial Code ("UCC") revisions regarding remotely created consumer items[3] into Regulation CC, presumably in **subpart** C.

II. Comments in Response to Specific Board Requests. We offer comments with regard firstly to the specific items for which the Board solicited comments in the Proposal, to the extent we desire to offer the same. Thereafter, we will offer below comments with regard to other issues surfaced under the Act or the Proposal.

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[2] Pub.L.No. 108-100, 117 Stat. 1177 (codified at 12 U.S.C. §§ 5001-5018). The Act was enacted on October 28, 2003, and rakes effect on October 28,2004.

[3] We have used the terms "remotely created consumer items" rather than "remotely created demand drafts" inasmuch as the former are terms used by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institutes in approved revisions to Articles 3 and 4 to the UCC.

A. MICR Line Creation and Repair (Regulation CC §§ 229.2(zz) and 229.51(c)).[4] The Proposal sets forth new rules for creating and repairing the MICR line on a substitute check, for both reconverting and collecting banks.[5] The Proposal also creates a new check group, the 'purported substitute check."[6] We are concerned that these new rules regarding the initial creation, or the subsequent repair, of a MICR line of a substitute check will unduly add new liabilities into the check collection process and raise unwarranted uncertainty as to the proper handling of a substitute check.

On the one hand, proposed § 229.2(zz) provides that a substitute check's MICR line may vary from the original check in two ways: (i) a reconverting bank may only repair an encoding error that appeased in the amount field of the original MICR line and (ii) the number in position 44 may vary to identify the check as a forward collection substitute check (by using "4") or a qualified return substitute check (by using "5"). On the other hand, proposed § 229.2(zz) effectively requires a reconverting bank to repair every MICR-read error in any field when it creates a substitute check.. These requirements are confusing and seemingly contradictory.

These rules will provide disincentives to the creation of accurate MICR lines and to the repair of MICR lines. They will also generate considerable operational and processing difficulties for banks, and uncertainty for banks and their customers. We urge the Board to revise these proposals so that simple, uniform principles can guide banks in the implementation of the Act.

1. MICR Repair of Misencoded Checks by Reconverting Bank Creating Substitute Check. With regard to comments involving the definition of a substitute check and the proposed provision dealing with a purported substitute check, we are troubled by the proposed distinction between MICR line amount repair and other MICR line repair on misencoded original checks in

[4] These cited sections relate to Regulation *CC*, subpart D, as proposed.
[5] See the commentary to proposed §§ 229.2(zz) (definition of substitute check) and 229.51(c) (concept of purported substitute check).
[6] Regulation CC § 229.51(c), as proposed.

the course of a reconverting bank creating a substitute check.[7] As an example in the proposed commentary suggests, in the process of creating a substitute check from an original check bearing a MICR line encoding error or omission, if a reconverting bank corrects such error or omission, the legal equivalence of that check turns on whether the correction is the MICR line dealing with amount or any other part of the MICR line. If the corrections deals with the amount, that substitute check enjoys legal equivalency; however, if the correction deals with any otber part of the misencoded MICR line, that check does not enjoy legal equivalency. In sum, amount repair will not change the check's status as a substitute check under subpart D. A reconverting bank may without peril correct the misencoded amount or unencoded amount and continue to treat the item as a substitute check.

Under the comments to the definition ofpurported substitute check, if the MICR repair of the original misencoded check involves any other change to the original MICR line, a copy reproduction of that check would not be considered a substitute check, even if that copy satisfies all of the other requirements of a substitute check' and all parties dealing with that check

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[7] Under the definition of substitute check, comment 5, example b, the following appears:

> b. It is a generally applicable industry practice for a bank that detects an encoding error in the amount field of the original check (including omission of the amount) to correct that error by repairing the MICR line, such as by placing an additional MICR strip containing the paying bank's routing number and the correct amount of the check beneath the original MICR line. In accordance with the generally applicable MICR-line repair practice for original checks and to facilitate processing of substitute checks in the same manner as original checks, a bank that creates a substitute check from an original check with a misencoded or unencoded amount or a bank that handles a substitute check that reproduces an amount encoding error that appeared on the original check may correct the amount encoding error that the bank detects. Such a repair will not change the item's status as a substitute check under subpart D. A paper reproduction of an original check that reproduced an uncorrected amount encoding error that appeared on the original check would, assuming all other requirements of the substitute check definition were met, be a valid substitute check that could be transferred, collected, or returned. However, subsequent banks that handled that substitute check and the drawer might have a claim for breach of an encoding warranty (see U.C.C. § 4-209 and § 229.34(c) of Regulation CC).

[8] Comment 1 to proposed Regulation CC § 229.51(c) dealing with purported substitute checks provides:

> 1. A reconvening bank must ensure that a substitute check bears a MICR line containing all the information appearing on the MICR line of the original check, except as provided under generally applicable industry standards for substitute checks to facilitate the processing of substitute checks. As discussed in the commentary to the substitute check definition, the MICR line of the substitute check could vary from the MICR line of the original check in two ways and still qualify as a substitute check: (1) the substitute check indicator in position 44 would be different on the substitute check and (2) the reconverting bank or a subsequent bank could correct an amount encoding error (including a failure to encode) that is traceable to the original check. If the MKCR line differs in other ways from the MICR line of the original check, the item would not meet rhe definition of substitute check. If the item is handled as if it were a substitute check,

thereafter treat it as though it were a substitute check. Indeed, if that check is handled as if it were a substitute check, Regulation CC § 229.51(c), as proposed, provides that the warranties, indemnity, expedited recredit, liability, and consumer awareness provisions would apply to that check as if it were a substitute check. That check, however, would not be the legal equivalent of the original check.

This proposed differentiation between MICR line misencoding repairs involving amounts and all other MICR line misencoding repairs is without a sound commercial foundation. We strongly believe that granting legal equivalency to all MICR line repair conforms to the operating requirements and expectations of the parties processing, receiving, presenting, and returning substitute checks. When a reconverting bank repairs the misencoded MICR line in connection with the creation of a substitute check, that check should be granted legal equivalency, regardless of the nature and extent of the MICR line misencoding repair. In the check collection process, MICR line repair of the misencoded amount and routing and transit number is a common practice by a collecting bank, a practice the Board should foster.[9] If the Board is not willing to grant legal equivalency regardless of the nature of the MICR line misencoding repair, it should at a minimum grant that equivalency to amount and routing and transit number MICR misencoding repair.

In the event a reconverting bank fails to place a MICR line on a substitute check that matches the original check's MICR line, and a collecting bank or paying bank experiences a loss as a result, including potentially losses from the paying bank's liability for consequential damages to a customer (such as damages for wrongful dishonor[10]), the collecting bank or paying bank should be protected under existing check law, at least in those states having UCC § 4209. Under the UCC, the reconverting bank would warrant that all MICR line information on the

however, this section provides that the warranties, indemnity, expedited recredit, liability, and consumer awareness provisions would apply to that item as if it were a substitute check. The item would not, however, be the legal equivalent of the original check,

[9] Absent an agreement between a collecting bank and a paying bank, the repair of the account number field (the "on-us" field) is highly uncommon by a collecting bank, due to the perceived risk of having the repaired check post against an account other than the account of the drawer, and causing a loss thereby.

[10] UCC § 4402.

substitute check is "correctly encoded."[11] The UCC provides that a person recovering under this warranty may recover damages in an amount equal to the "loss suffered as a result of the breach," plus expenses and lost interest." A warranting bank would be liable under this UCC section for consequential damages, such as damages arising at the paying bank as the result of wrongful dishonor of subsequent checks due to the encoding error.[13] We believe that, given the importance of the MICR line encoding to the processing of a substitute check, the liability should be passed back to the reconverting bank in the manner provided under such UCC encoding warranty.

We request that the final rule confirm in the commentary the above interpretation of the application of the UCC encoding warranty to a substitute check that (i) has MICR line information that does not match the MICR line information on the original check, or (ii) does not include the proper encoding in position 44 according to the generally applicable industry standards for substitute checks. Recognizing that the 1990 amendment to UCC § 4209 has not been adopted in each of the states,[14] we also request that the Board revise the damage provision under Regulation CC § 229.34(d) to provide that, with respect to substitute checks only, in the event of a breach of the encoding warranty a warranting bank is liable for the same damages that could be recovered by a claimant bank under UCC § 4209(c).[15] An alternative to this approach would be for the Board to otherwise revise subpart D of Regulation CC to directly provide that liability arising from a MICR encoding error on a substitute check, including potentially consequential damages that a paying bank must pay to its customer, is appropriately passed back to the reconverting bank.

2. **MICR-Read Error by Reconverting Bank Creating Substitute Check.** A MICR line error could also occur if an automated check sorter of a truncating bank electronically

[11] UCC § 4209(a). Note that the failure of the reconverting bank to place a MICR line on a substitute check that matches the MICR line on the original check does not result in a breach of warranty under the Act requiring the substitute check to meet all of the Act's requirements for legal equivalence.
[12] UCC § 4209(b).
[13] See, B. Clark & B. Clark, Law of Bank Deposits, Section 16.03[2].
[14] New York is a salient example.

misinterprets the MICR line data, such that the MICR line information actually used to process the check electronically was incorrect or incomplete. For example, the check sorter could have read a MICR line incorrectly (e.g., reading a "3" instead of an "8") or intentionally substituted one character for another (such as replacing a space or a hyphen with a "0"). These differences from the MICR line of the original check constitutes a MICR-read error. The Proposal takes the view that a paper reproduction of an original check containing such a MICR-read error would not satisfy the requirement of a substitute check. Indeed, the reconverting bank is encouraged to repair all MICR-read errors to ensure that the check transferred by it meets the substitute check definition.[16] If a reconverting bank fails to so repair, a paper reproduction of an original check containing a MICR-read error, but that purports to be a substitute check, such as by containing the legal equivalence legend, would be a substitute check for purposes of warranties, indemnities, expedited recredit, liability, and consumer awareness provisions.

. We take issue with this view. Why does the Proposal treat amount MICR encoding errors differently from MICR-read errors? With amount encoding errors, the reconverting bank is under no obligation to repair; it may without peril convert the original amount misencoded check to a substitute check and enjoy legal equivalency, assuming that all of the other requisite

[15] We are mindful that the statute of limitations under UCC § 4111 is three years and one year under Regulation CC § 229.38(g), so the pariry we seek will not be completely achievable.

[16] Under the definition of substitute check, comment 5, example c, the following appears:

> c. A MICR-line error could occur if the automated check sorter of the bank that truncated the original check elecnonically misinterpreted the MICR line data, such that tbe MICR line information actually used to process the check electronically was incorrect or incomplete. For example, if the check sorter detected but could not fully interpret the MICR line, the electronic MICR-line information would contain asterisks where the uninterpreted MICR data should appear. Similarly, the check sorter could have read a number in the MICR line incorrectly (such as reading a "3" instead of an "8") or intentionally substituted one character for another (such as replacing a space or a hyphen with a "0") when converting the MICR-line information to electronic form. Each of these differences from the MICR line of the original check constitutes a MICR-read error, and a paper reproduction of an original cbcck that contained such a MICR-read error would not satisfy the substitute check definition. To ensure that the item transferred by the reconverting bank meets the substitute check definition, the reconverting bank should repair all MICR-read errors (see, for example, American National Standards Specifications for Electronic Exchange of Check and Image Data, X9.37, which contains provisions that facilitate the repair of the MICR line). As discussed in more detail in § 229.51(c) and the commentary thereto, a paper reproduction of an original check that contains a MICR-read error but that purports to be a substitute check, such as by containing tbe legal equivalence legend or by being delivered when an original check is required, would be a substitute check for purposes of §§ 229.52 through 229.57 of Regulation CC but would not be the legal equivalent of the original check.

elements of a substitute check were satisfied.[17] However, with MICR-read errors, the reconverting bank is strongly encouraged (or even under an implied obligation) to effect repairs: "the reconverting bank should repair all MICR-read errors."[18] If the reconverting banks were required to repair MICR-read errors, such an undertaking would delay the processing of substitute checks. If the reconverting bank fails to so discharge this obligation, the reproduced check is merely a purported substitute check, enjoying no legal equivalency.

Even if a MICR-read error is not repaired by a reconverting bank, we urge that the purported substitute check created by it be granted full legal equivalency. The status of a substitute check containing MICR information in MICR ink as the legal equivalent of the original check for all parties down the check collection chain should not be dependent on whether the MICR line is properly read from the original check and printed on the substitute check. Banks in the check collection process, such as collecting banks and paying banks, and nonbank parties that receive a substitute check (e.g., the drawer), need to know that they can process the substitute check and treat it as the original check. In many cases, a collecting bank will not know that there is an error in the MICR line of a substitute check that the bank receives from the reconverting bank, and the collecting bank will transfer that check to a subsequent collecting bank or to the paying bank.

Moreover, in the event the reconverting bank fails to place a MICR line on a substitute check that matches the original check's MICR line as a result of a MICR-read error, and a collecting bank or paying bank experiences a loss as a result, including potentially losses from the paying bank's liability for consequential damages to a customer (such as damages for wrongful dishonor), the collecting bank or paying bank should be protected under existing check law under UCC § 4209, as outlined above. We again reiterate our request for revisions to Regulation CC § 229.34(d) to provide that, with respect to substitute checks only, in the event of a breach of the encoding warranty a warranting bank is liable for the same damages that could be recovered by a claimant under UCC § 4209(c).

[17] Of course, if the reconverting bank misencoded the check, it may incur liability under UCC § 4209.
[18] Footnote 16, *supra.*

3. MICR Line Repair by a Bank Other than the Reconverting Bank. If the MICR line repair on a substitute check is rendered by a bank other than the reconverting bank (such as a collecting or paying bank), the proposed commentary related to both the definition of substitute check and the provision dealing with purported substitute check again draws a distinction between MICR line amount repair and all other repairs. If the MICR line repair of a substitute check is solely with regard to amount, that does not affect the legal equivalency of the substitute check; however, if the MICR line repair involves other portions of the MICR line, that substitute check as repaired, no longer enjoys legal equivalency.

Nevertheless, the check would be viewed as a purported Substitute check. If that purported substitute check, as repaired, is handled as if it were a substitute check, § 229.51(c) provides that the warranties, indemnity, expedited recredit, liability, and consumer awareness provisions would apply to that check, The collecting or paying bank repairing the check would incur all of the liabilities and responsibilities under the Act with regard to that repaired substitute check, but not the benefit; of legal equivalency. Under the Proposal, a collecting bank receiving a substitute check and determining that it contains an error on the MICR line would be required as a practical matter to return that substitute check upstream to the reconverting bank. Since, under the Proposal, the substitute check is not the legal equivalent to the original check, the collecting bank has no authority to repair the substitute check or to present the substitute check to the paying bank for payment.

Similarly, absent an agreement, a paying bank would have no authority to charge its customer even if the paying bank could determine that the substitute check was otherwise properly payable, the MICR line error notwithstanding. If that repaired check does not enjoy the status of legal equivalency under the Act, absent an agreement that the paying bank will accept presentment in some other form, the paying bank has no obligation to accept the purported substitute check from the collecting bank. The paying bank is only obligated to honor the

original check.[19] These results are in contravention of the chief goal of the Act, to encourage the acceptance and collection of substitute checks,

We recommend that the final rule under the Act provide that a collecting bank or a paying bank may, at its option, repair any portion of a MICR line on a substitute check that it receives in the check collection process. There should be no obligation under the Act for a collecting bank or a paying bank to repair the MICR line on a substitute check. If a collecting or paying bank does repair a substitute check, that repair should not implicate the Act, regardless of whether the repair is done correctly or incorrectly, and regardless of whether fill or partial MICR line is placed on the repaired substitute check. The repair of a substitute check by a collecting bank or paying bank would not implicate the warranties under the Act, because a repair of a MICR line does not affect whether or not the image of the original check printed on the substitute check accurately reflects the information from the original check, Furthermore, a substitute check that is repaired should not lose its status as the legal equivalent to the original. check, regardless of type of repair (full or partial) and regardless of the accuracy of repair. Rather, the collecting bank or paying bank that repairs a substitute check in a manner that results in an inaccurate MICR line information (full or partial) would breach the encoding warranties under the UCC and Regulation CC.

We suggest that substitute checks repaired by collecting banks and paying banks be treated with the same legal equivalency standard, regardless of the basis for the repair of the MICR line. The distinction between mount MICR repair and all other repairs is not commercially sound. All MICR line repairs should be treated with equal dignity. The Board has an interest in fostering the repair of MICR lines, both as to amount and all other information. The safe harbor granted to amount MICR line repair is not warranted; all repairs should be treated equally.[20]

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[19] UCC § 3501.

[20] One risk in adopting this proposal of granting legal equivalency to all MICR line creation by reconverting banks or MICR line repair by collecting banks and paying banks is that the general quality of the MXCR line of substitute checks could decline. If the reconverting bank or collecting bank understands that the paying bank must honor substitute checks regardless of the quality or readablility of the MICR line due to those checks enjoying legal equivalency (notwithstanding such MICR line flaws), reconverting banks and collecting banks will have little incentive to create substitute checks with high quality machine-readable NICR lines or effect high quality repairs of

Further, in the event the bank effecting the repair (other than the reconverting bank) fails to effect such repair on a substitute check that matches the original check's MICR line, and a subsequent collecting bank or paying bank experiences a loss as a result, including potentially losses from the paying bank's liability for consequential damages to a customer (such as damages for wrongful dishonor), the subsequent collecting bank or paying bank should be protected under existing check law, as outlined above. We again reiterate our request for the changes to Regulation CC § 229.34(d) to cover such MICR repair errors as well.

4. **MICR Lines of Returned Substitute Checks.** In the context of returning substitute checks, the proposal is to amend existing sentences in Regulation CC §§ 229.30(a)(2)(iii) and 229.31(a)(2)(iii) relating to the proper MICR line encoding of a qualified returned check These proposed amendments would specify that a qualified returned substitute check must contain a "5" in position 44 of the MXCR line, whereas a qualified returned original check must contain a "2" in that position.

Given the foregoing, if a paying bank were to generate a substitute check for the purpose of facilitating the return of that check, the Proposal is not entirely clear on the obligation of the paying bank with regard to position 44. We read the proposal as follows:

- The paying bank creates a substitute check with a MICR line, including a "4" in position 44.
- To the substitute check, the paying bank affixes a strip with a MICR line, including a "5" in position 44. A "5" is only intended to be used on a qualified return strip.
- In the alternative, the paying bank may enclose the substitute check in a carrier envelope (ifpermissible for substitute checks under industry standards) and that envelop bears a new MICR line, including a "5" in position 44.

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the MICR lines. If the paying banks rejects substitute checks due to low quality MICR lines, the paying bank risks wrongful dishonor liability under UCC $4402. Perhaps this result must be accepted as one unintended consequence

We do not read this proposal to mean that the paying bank in creating a substitute check places a "5" in position 44 on the substitute check itself If that were the reading, the substitute check may cause difficulty if it were redeposited by the depository bank or its customer. Because the forward collection substitute check would have a "5" in position 44, it may be subject to mishandling by collecting banks. Further, if that collecting bank were to convert original checks to substitute checks, that redeposited substitute check (bearing a "5" in position 44) could become reconverted to a substitute check because it does not have a "4" in position 44, a requirement for forward collection substitute checks.

Please confirm the understanding that the paying bank places a "5" on the MICR line strip to the original substitute check it creates (with a "4" in position 44).

5. Position 44. With regard to MICR line errors, one of the issues not expressly addressed in the Proposal relates to position 44. ANS X9.90 requires that a forward collection substitute check use a "4" in position 44 and a qualified return substitute check use a "5" in position 44. Two issues are surfaced with regard to position 44.

a. Failure of a Reconverting Bank to Place a Code. We seek clarification under *the* final rule that, if a reconverting bank or a repairing bank fails to place, or place correctly, a required code in position 44 in compliance with the generally applicable industry standards, that failure (i) would not affect the status of the substitute check as the legal equivalent of the original check, and (ii) would not constitute a breach of the Act's warranties. Rather, it is our view that the failure to encode, or to encode properly, position 44 on a substitute check would constitute a breach of the UCC encoding warranties under UCC § 4209(a), as discussed above. In that connection, we again reiterate our request to revise Regulation CC § 229.34(d) as outlined above. With respect to the legal equivalency issue, we have discussed in the prior sections of this letter the reasons why the correct or incorrect MICR line information should not affect the

of this proposal. This anticipated adverse impact may also be mitigated through clearing house rules establishing a process under these circumstances.

legal equivalence of a substitute check. The same rationale applies to the position 44 encoding on a substitute check.

b. Failure to Place a Code by a Reconverting Bank and a Subsequent Creation of a New Substitute Check. The Proposal does not require a reconverting bank to place a numeral code in position 44 of a forward collection check or to identify it as a substitute check, One purpose of the identifying numeral code to prevent a bank from further reducing a substitute check in size when it mistakenly believes that it is reconverting the original check, not a substitute check. If a reconverting bank were to create a substitute check, but were to use inferior ink so that the "4" or "5" were illegible or were to neglect to use a "4" or "5," a subsequent collecting or returning reconverting bank may inadvertently convert that substitute check into another substitute check by automated means, but the image of that check would be significantly reduced so that it may become illegible. The subsequent reconverting bank may face breach of warranty claims under the Act because the check image may not accurately represent "all of the information on the front and back" of the original check." Under the Act, a breach of warranty may involve the attachment of consequential damages. However, the Act and the Proposal do not address whether the original or other earlier reconverting bank has liability to the subsequent reconverting bank, The subsequent reconverting bank may not have a breach of warranty claim against the original or other earlier reconverting bank because that bank did not breach the § 229.52(a)(1) warranty (provided all of the information reproduced on the larger substitute check is still legible).

Under the foregoing circumstances, we believe that the bank cawing the loss should assume responsibility for possible consequential damages. In the event of a claim under the Act based on breach of warranty, the original reconverting bank should be liable to the subsequent reconverting bank as to the consequential damages liability, due to the failure of that reconverting bank to satisfactorily place the appropriate code in position 44. We urge the Board to develop this predicare of liability, even if that predicate is merely through additional

[21] The Act, at § 4(b)(2). See also the Proposal, at page 75, providing that the second reconverting bank warrant the legal equivalence of the first and second substitute check.

commentary to the existing rules. This liability, e.g., may be based on a possible breach of Regulation CC § 229.34(c); accordingly, § 229.34(d) would require an amendment as suggested above.[22]

B. Purported Substitute Cheeks. The term "substitute check" under *the* Act means a paper reproduction of the original check, bearing a MICR line.[23] Thus, a check meeting all other substitute check requirements but missing a MICR line or containing a MICR line that is not printed in magnetic ink is not a substitute check.[24] However, under Regulation *CC* § 229.51(c), as proposed under the Proposal, a check missing a MICR line or having an unreadable MICR line could be considered a substitute check if it were handled as if it were: a substitute check, and the warranties, indemnity, expedited recredit, liability, and consumer awareness provisions would apply to that check.

We view this provision dealing with purported substitute checks as an unauthorized expansion of the Act, as *to* checks with no MICR lines or unreadable MICR lines, Given the comments offered above by us, we generally have reservations regarding the concept of purported substitute checks, We believe that the warranty and indemnification obligations under the Act should only attach if a substitute check that is the legal equivalent of the original check is created. Any check that fails to meet any of the substitute check requirements in Regulation CC § 229.2(zz), as proposed, should not be treated as a purported substitute check.

C. Indorsement Requirements of Returning Banks. Appendix D currently does not contain any content requirements for returning bank indorsements and implicitly permits the indorsements to be placed on the front of the check. Under *ANS* X9.90, however, a returning bank that is also a reconverting bank with respect to a substitute check must be identified as such on the back of the check. Therefore, the Board proposes to amend appendix D to require returning bank indorsers to comply with the same indorsement requirements as collecting banks.

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[22] This liability would be based on a breach of the warranty relative to the MJCR information under Regulation CC § 229.34(c) and enhancement of the liability under § 229.34(d) in states not adopting UCC § 4209..

[23] The Act, at § 3(16).

[24] Comment 6 to §229.2(zz), dealing with "substitute check."

Specifically, the Board proposes to require that a subsequent collecting bank or returning bank's indorsement be applied to the back of a check and include only (1) bank's nine-digit routing number, and if the returning bank is a reconverting bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconverting bank, (2) indorsement: date, and (3) an optional trace or sequence number,

The Board further requests comment on what benefits, if any, there would be in providing returning banks with the flexibility to indorse on the front of checks and to include additional information in their indorsements.

We believe that a returning bank's indorsement should be on the back of checks. The back of checks has historically been the location for indorsements. Having the returning bank's indorsement on the front of both regular checks and substitute checks will likely lead to confusion in check processing.

Notwithstanding our opposition, in the event the Board permits a returning bank's indorsement on the front of the check, that indorsement's location should follow a protocol.. The indorsement should be restricted to a specific area of the front of the check so that banks or customers applying security measures on the face of checks may take the anticipated location of the indorsement on the front of the check into account when applying such measures.

D. Indorsement Requirements of Paying Banks. The Board observes that Regulation CC currently does not require a paying bank to indorse a check. To facilitate compliance with the Act, at § 4, however, a paying bank that is also a reconverting bank with regard to a substitute check should be identified as such on the check in a manner that a subsequent reconverting bank may preserve. Therefore, the Board proposes to amend appendix D to require a paying bank that is also a reconverting bank with respect to a substitute check to identify itself as such by placing on the back of the check its nine digit routing number (without arrows) and an asterisk at each end of the number. This identification would not constitute an indorsement. The Board also proposes other technical amendments to appendix D.

The Board requests comment on, all aspects of the proposed indorsement and identification standards discussed above.

We have no specific comments on the Board's proposed indorsement and identification standards for paying banks. However, we *are* concerned that shifting of indorsements when a check is converted to electronic form and then thereafter reconverted in reduced size into a substitute check could result in frequent overlapping and illegible indorsements. We believe that the Board should carefully consider this issue before it finalizes its indorsement standards.

E. ACH Debit Entry. One of the warranties made by a bank that transfers, presents, or returns a substitute check for which it receives consideration is that no depositary bank, drawee bank, drawer, or indorser will be asked to make a payment on a check that it has already paid.[25] This warranty is commonly referenced as the "no double debit" warranty.

The Board requests comment on whether using infomation from a check to create an ACH debit entry should be a payment request covered by this warranty.

We do not believe that using information from a check to create an ACH debit entry should be a payment request covered by this warranty. As noted by the Board on page 16 of its analysis, using information from a check to create an ACH debit entry is a "check conversion" covered by Regulation E not a check transaction covered by the UCC and Regulation CC. The check from which the ACH debit is created is never introduced into the check collection process. NACHA rules provide their own warranties to cover cases in which a check that was converted to an ACH entry does find its way into the check-collection process, unless the rules specifically permit the check's reintroduction.[26] ODFIs breaching these warranties indemnify any

[25] The Act, at § 5.
[26] See, e.g., NACHA Rule 2.2.1.11 (source document for a POP entry has been voided and returned to the customer); NACHA Rule 2.8.3.7(the item to which an RCK entry relates will not be presented to the RDFI, unless the related RCK entry is returned); and NACHA Rule 2.9.3.4 (source document for an ARC entry will be destroyed within 14 days of the settlement dare).

subsequent party for whatever damages result from the breach, including attorney's fees?[27] The NACHA rules thus provide sufficient protection to the parties so that warranties under Regulation CC would be superfluous,

F. Banking Day. Proposed Regulation CC § 229.54 (b)(3) clarifies that a bank requiring a consumer to submit an expedited recredit claim in writing must compute the time period for acting on the claim from the date that the consumer submitted the Written claim, even if the consumer previously provided some information relating to the claim in another form. Proposed Regulation CC § 229.54(c) provides that "banking day" (instead of "business day" under the Act) is to be used to begin measuring the time period for a bank's action.

We agree that a bank's time period for acting on a consumer's expedited recredit claim should be computed from the date that the consumer submitted the written claim even if the consumer previously provided information regarding the claim in another form. We also agree that "banking day" should be used to begin measuring the time period for a bank's action.

G. Reorganization of the Expedited Recredit Claim Process. Proposed Regulation CC § 229.54(c) incorporates each of the Act's substantive requirements regarding action on a consumer's expedited recredit claim, but reorganizes those requirements in a way that the Board believes is more straightforward.

The Board requests comment on whether its proposed reorganization of the statutory provisions regarding action on claims is an improvement over rhe statutory organization and encourages commenter to provide specific organizational suggestions.

We commend the Board on its proposed reorganization of the statutory provisions regarding action on claims. We believe that it is a significant improvement over the statutory organization.

[27] See NACHA Rules 2.2.3 (POP entries), 2.8.3.11 (RCK entries), and 2.9.3.5 (ARC entries).

H. Right to Reverse Recredited **Amounts, Including** Interest. After providing a recredit, if a bank later determines that the consumer's claim is not valid, proposed Regulation CC § 229.54(c)(4) would allow the bank to reverse both the amount it previously recredited plus any interest that it has paid on that amount. The Act does not explicitly address the reversal of interest when reversing a recredit.

The Board requests comment on whether the approach proposed in § 229.54(c)(4) is appropriate.

We agree with the approach proposed in § 229.54(c)(4) whereby a bank that determines that a consumer's claim is not valid would be allowed to reverse both the amount it previously recredited plus interest that it has paid on the recredited amount. By granting regulatory authority to the reversal, a bank would be able to avoid claims based on, among other claims, wrongful dishonor, in the event the reversal causes the account balance to decline, resulting in subsequent dishonored items.

I. Multiple Substitute **Check Claim.** The proposed commentary to Regulation CC § 229.54(c) clarifies that a bank receiving claims for multiple substitute checks in the same communication must provide the expedited recredit for each such check by the 10th business day thereafter, unless the bank by that date has determined whether or not the claims are valid. The commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation of the claim.

The Board requests comment on whether additional commentary to § 229.54 would be useful and, if so, what specific points should be covered.

We do not believe that any additional comments to § 229.54 would be useful.

J. Timing of Delivery of Consumer Disclosure. The Act, at § 12(b)(4), a bank is required to provide the consumer disclosure at the time a consumer requests a copy of a check and receives a substitute check. The Board views this requirement as burdensome. At proposed Regulation CC § 229.57(b)(2), the Proposal suggests two choices for the timing of the consumer education documents:

> **(2) Disclosure** to consumers who receive substitute checks only an occasional basis. Unless a bank already has provided the disclosure described in paragraph (a) *of this* section, the bank must provide such disclosure to a consumer customer of the bank who—
> [Alternative 1: (i) Requests an original check or a copy of a check and receives a substitute check, at the time of such request;]
> [Alternative 2: (i) Requests an original check or a copy of a check and receives a substitute check, at the time the bank provides such substitute check;] or
> (ii) Receives a returned substitute check, at the time the bank provides such substitute check.

We would support alternative number 2, with a stipulation that the disclosure documents may be provided at any time, up to the time of delivery of the substitute check. This proposal provides optimum flexibility to banks providing the document.

Further, in that regard, we strongly indorse the Proposal, at page 26 and at Regulation CC § 229.57(b)(2), in which the Board expressly authorizes banks to provide disclosures at an earlier period.

K. Form and Content of Model Consumer Notice. The proposed amendments to appendix C includes a model consumer notice form as model **C-SA.**

The Board requests comment on whether the proposed model notice is clear, accurate, and concise.

The **new** Model **C-5A** substitute Check **Policy** Disclosure **is unduly** complex and lengthy. The notice **would** appear to be inconsistent **with** the most recent proposals by the **Board** relative to disclosures generally under **Board** regulations, **establishing a proposed new** "clear and conspicuous" standard?' A disclosure in excess of two **pages** is complex and **confusing.** Further, we note that the notice references the expedited **right** to recredit, **a right** granted **only** to consumers. **The** notice should **clarify** that this expedited **right is** available **only *to*** consumers. While the Act's obligations to provide this notice deals **solely** with **consumers,**[29] the addressee **of** the **notice is "you" with** no differentiation between consumers **and** nonconsumers.

We recommend that this disclosure be abbreviated, **as** follows.

You may receive **from us** in certain cases a substitute check, **instead of** the original **check you** wrote. For example, you **may receive** a substitute check, **instead** of **an original check, in your** account statement, when you request a **copy** of **a** paid check, **or** when **checks** that you deposited are returned unpaid **and** charged **back against your** account. **A** substitute check **is a** copy of the original check that **is** the same **as** the **original** check.**for** all purposes, **including** that **you** made payment. **A** substitute check **is** the size **of** a typical **business** check, includes **an** accurate copy of the front and **back** of the **original** check, **and contains** the **words: "This** is **a** legal copy of ***your*** check. You can use it the **same *way* you would use the original** check."

Federal law **provides consumer customers** with certain rights, including an expedited recredit of the amount of **the check** (up to $2,500 **within** 10 **days and** the remainder no **later** than **45 days),** plus interest **for** interest **bearing** accounts, if you incur **a** loss **because** you received a substitute **check instead** of **your** original check. We may reverse a recredit **after** our investigation of your claim, if **we** determine that the substitute check **was** properly charged to your **account. You** must contact **us** within 40 calendar **days** of the later of **(i) your** receipt of **your** monthly statement **showing** the substitute check being **charged** to your

[28] **See Board proposal docket** numbers R-11-1168 **through** R-11-1172.
[29] The Act, at § 7.

account, or (ii) the date we made the substitute check available to you. We may in certain cases extend this 40 day time period. If you believe you incurred a loss because you received a substitute check, please contact us by [insert bank contact information].

L. Other Model Forms. The proposed amendments to appendix C also include models for the notices a bank must provide in response to a consumer's expedited recredit claim. No statutory safe harbor applies to the proposed model notices.

In light of the absence of a safe harbor, the Board specifically requests comment on whether providing model languages for the notices is useful.

We believe the model language for the notice is useful even in the absence of a statutory safe harbor. These forms will be widely used by banks. We recommend that the Regulation CC contain a statement that in the Board's view a bank's use of the models would constitute compliance with the Act with no forms excepted.

M. Other **Regulation CC Subjects.** The Board requests comment on several topics unrelated to Check 21:

- Section 229.2 Definitions.
- Section 229.10 Next-day Availability.
- Section 229.13 Exceptions.
- Section 229.15 General Disclosure Requirements.
- Section 229.30 Paying Bank's Responsibility for Return of Checks. Current Regulation CC § 229.30(c)(1) allows for extensions for the deadline of a return or notice of nonpayment under the UCC or Regulation J when a paying bank uses a means of delivery that ordinarily would result in receipt by the receiving bank's next banking day. The proposed amendment would more specifically describe the applicable time of receipt to be the bank's cutoff hour for the next processing cycle (if sent to a returning bank) or next banking day (if sent to a depositary bank.
- Section 229.33 Notice of Nonpayment.

- Section 229.37 Variation by Agreement.

We do not agree with the proposal to more specifically describe the applicable time of receipt to be the bank's cutoff hour for the next processing cycle if sent to a returning bank. This cutoff hour may be difficult for a paying bank to determine, leading to uncertainty. We believe the applicable lime of receipt for both a returning bank and a depositary bank should continue to be the bank's next banking day,

In addition to the proposed changes to Regulation CC, we suggest the additional following change. Currently, Regulation CC requires the following written notices to provide, among other information, the account number of the customer:

- A notice of a case-by-case delay under Regulation CC § 229.16(c)(2).
- An extended hold notice under Regulation CC § 229.13(g).

Furthermore, in the event a depository bank elects to use the notice of nonpayment to notify its customer in the event that bank receives a notice of nonpayment, the account number will be included in that notice, as required by Regulation CC § 229.33(d).

With the mounting increase in identity thefts, we are concerned about using account numbers in our communicationsto customers. We suggest that in the comments to Regulation CC the Board permit banks to redact all but four digits to comply with these requirements, similarly to the account identification requirement in Regulation E § 205.9(a)(4).[30] By permitting banks to so redact, the risk of identity theft and other fraudulent losses may be mitigated.

N. Remotely Created Consumer Items. We support the Board revising Regulation CC to provide a new warranty relating to remotely created consumer items. We would propose that the

[30] 12 C.F.R. Part 205.

final rule on this matter include some minor changes to the warranty from the version of the warranty set forth in the NCCUSL amendments to Articles 3 and 4.

Firstly, the warranty should apply to all remotely created items, not just those that are drawn against consumer accounts. We see no basis for distinguishing between consumer and nonconsumer accounts in this regard. Further, as a practical matter, a depository bank or a paying bank may find such distinction difficult to administer. Therefore, a paying bank may be unable to determine whether the warranty applies, to enable it to return the item to the depository bank, and the paying bank may also be unable to determine whether the warranty applies, to enable it to evaluate the breach of warranty claim.

Secondly, we would recommend that the new warranty under Regulation CC warrant that the item is authorized according to all the terms of the item, not just the amount of the item. This second recommendation is consistent with the laws in a number of states that have adopted provisions relating to unsigned demand drafts.

Thirdly, note that the statute of limitations under the UCC with regard to demand *draft* breach of warranty claims is three years, for those states that have adopted demand draft legislation.[31] If Regulation CC were to create a new warranty with regard to remotely created items, the following is raised with regard to the statute of limitations;

- Would the remotely created item breach of warranty claim be subject to the one-year statute of limitation period provided in Regulation CC § 229.38(g), assuming that such items are included within subpart C?
- If such statute of limitations period applied, would inconsistent state providing a three-year statute of limitations period be preempted or superseded?[32]

We urge the Board to preserve the three year statute of limitations under state law for those states that have adopted demand draft legislation.

[31] E.g., California UCC §§ 3118 and 4111.
[32] See Regulation *CC* § 229.41.

Finally, given that the issue of remotely created items does not have the same time urgency as the provisions implementing the Act, we request that the Board provide a second proposal on this issue to provide the financial services industry with the opportunity to review and comment upon the text of the proposed change to Regulation CC before it is implemented.

III. Additional Comments. We offer below comments with regard to items not specifically addressed in the Proposal or for which the Board did not solicit comments directly.

A, Making Substitute Checks Available with Periodic Statements. With regard to the expedited recredit process, the Board appears to have created a requirement that the substitute check be provided to the consumer (through mailing or delivery) in order to have this right attach. However, this requirement is inconsistent with the plain meaning of the Act. In this regard, we voice concern with the Proposal, as follows.

Under the Act, at § 7(a)(2), the 40-day period under which the consumer must submit an expedited recredit claim is computed as follows:

> (2) Any claim under paragraph (1) with respect to a consumer account may be submitted by a consumer before the end of the 40-clay period beginning on the later of—
> (A) the date on which the financial institution mails or delivers, by means agreed to by the consumer, the periodic statement of account for such account which contains information concerning the transaction giving rise to the claim; or
> (B) the date on which the substitute check is made available to the consumer. (Emphasis supplied.)

These emphasized terms suggest that the financial institution must mail or deliver the periodic statement evidencing the transaction giving rise to the claim. However, the financial institution need not expressly mail or deliver the substitute check to the consumer; it may make the substitute check available to the consumer.

This language in § 7(a)(2) of the Act must be contrasted with Regulation CC § 229.54(b)(1), as proposed. This proposed subdivision applies the mailing or delivering requirement to both the periodic statement and the substitute check, triggering the commencement of the 40-day period from such mailing or delivery:

> (1) Timing of claim. (i) The consumer must submit his or her claim to the bank by the end of the: 40th calendar day after the later of the calendar day on which the bank mailed or delivered, by a means agreed to by the consumer—
> (A) The periodic account statement that contains information concerning the transaction giving rise to the claim; or
> (B) The substitute check giving rise to the claim. (Emphasis supplied.)

Thus, the Board has failed to acknowledge and follow the plain language of the Act by subjecting the mailing or delivery requirement to *both* the periodic statement and the substitute check. This language significantly undermines the ability of a financial institution to make substitute checks available to the consumer by other methods. For example, if a bank were to hold the mailing of periodic statements at a branch office under a consumer's instruction, the bank is making the statements available to the consumer, but arguably it is not mailing or delivering the statements to the consumer in compliance with the Proposal. By failing to meet this mailing or delivery requirement, an indemnifying bank may, e.g., deny the paying bank's request for expedited recredit, because the indemnifying bank may contend that the expedited recredit did not meet the requirements of the Act.

We urge the Board to restore the language of the Act in proposed § 229.54(b)(1) by providing:

> (1) Timing of claim. (i) The consumer must submit his or her claim to the bank by the end of the 40th calendar day after the later of the calendar day on which the bank —
> (A) mailed or delivered, by a means agreed to by the consumer, the periodic account statement that contains information concerning the transaction giving rise to the claim; or
> (B) made available the substitute check giving rise to the claim.

This language restores the Act's original intent, to grant flexibility in *the* manner in which the substitute check may be made available to the consumer.

If the Board is receptive to this proposal, corresponding changes to the comments to this section should also be made.

B. Electronic Images. Under the Proposal, a bank may limit its liability for an indemnity claim and may respond to an expedited recredit claim by providing the claimant with the original check or a copy of a check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or that otherwise is sufficient to determine the validity of the relevant claim. However, a copy must be a paper reproduction of a check; an electronic image that appears on a computer monitor but has not yet been printed is not a copy or a sufficient copy."

We believe that this distinction between an image of the original check and a hardcopy is without merit. So long as a hardcopy may be printed from an image, that image should be deemed to be a sufficient copy and a copy.

C. Breach of UCC Warranties. With regard to a claim for expedited recredit under Regulation CC § 229.54(a), as proposed, a consumer may make a warranty claim under the following:[34]

- A substitute check warranty under Regulation CC § 229.52, as proposed;
- Any other warranty that a bank provides under Regulation CC § 229.34;
- The UCC; and
- Any other law.

[33] Comments 1 and 2 to § 229.2(aaa).
[34] Comment 2 to § 229.54.

Under the UCC, as adopted in a number of jurisdictions in the United States, a consumer (or any other drawer of a check), as a drawer of a check, only has a warranty claim under UCC § 4205(b) as against a depository bank: the amount of the check was paid to the depository bank's customer or deposited into the customer's account.[35] No other express statutory warranty appears to run in favor of the consumer under the UCC.[36] Granting to a consumer the right to assert this UCC breach of warranty claim is outside the purview of the Act, even assuming such a warranty claim is available thereunder to the consumer. (Indeed, we do not believe that a consumer has a direct warranty claim against paying or collecting banks under UCC § 4205(b), the consumer only has that breach of warranty claim against the depository bank.) Similar arguments may be advanced relative to claims under Regulation CC § 229.34 and other state law. The core purpose of the Act is to facilitate check truncation by authorizing substitute checks.[37] Whether the depository bank paid the amount of the check to its customer or deposited the amount of the check to the customer's account has no direct bearing on facilitating check truncation. Warranty claims for expedited recredit under Regulation CC § 229.54 should have some reasonable nexus to the underlying purpose of the Act. Nothing in the Act indicates that Congress intended breach of warranty claims under the UCC or other regulations or laws to be subject to this expeditious recrediting remedy. Further, we believe that a claim for recredit may become unduly complex if other collateral issues are permitted to be brought forward by the consumer.

Based on the foregoing, we urge that only expedited recredit claims under the Act fall within this procedure.

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[35] UCC § 4205 provides;

> If a customer delivers an item to a depositary bank for collection both of the following epply:
>
> (a) The depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the itern, and, if the bank satisfies the other requirements of Section 3302, it is a holder in due *course.*
>
> (b) The depositary bank warrants to collecting banks, rhe payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

[36] Compare UCC § 4205 with UCC §§ 4207 (warranties of customer or collecting bank upon transfer of an item) and 4208 (wananties of person obtaining payment and previous rransfer). Thus, the reference to other UCC warranty claims is unclear.

[37] The Acr, at §2(b)(1).

D. Statute of Limitations. Under the Act, at § 11(a)(2), a cause of action accrues as of the date the injured party first learns, or by which such person reasonably should have learned, of the facts and circumstances giving rise to the cause of action. Regulation CC § 229.56(c), as proposed, provides that the cause of action against a bank accrues as of the date the injured party first learns of the identity of the warranting or indemnifying bank against which the action is brought.[38] We are uncertain of the specific purpose of this additional qualification for having a cause of action accrue. The Act merely speaks in terms of the cause of action accruing when an injured party learns, or should have learned, of the facts and circumstances giving rise to the cause of action, Expanding accrual to when an injured party learns, or should have learned, of the identity of the warranting or indemnifying bank appears to unduly lengthen the statute of limitations under the Act.

E. Problems in Creating Substitute Checks. In creating a substitute check, a reconverting bank may encounter checks with security features so that some or all of the information on the original check may not appear on the image thereof by design of such check, We understand that an issuer of money orders, for example, sells money orders with a security feature so that an image of the money order does not contain the amount thereof. We further understand that some colors of ink, such as red, or darkly colored checks do not image well. Imaging a check originally drawn with red ink results in a copy with the handwritten information virtually illegible. An image of a check originally drawn on dark paper results in an illegible copy as well.

If the reconverting bank is unable to generate an accurate image of all of the information on the front and back of a check as of the time the original check was truncated, the reconverting

[38] Regulation CC § 229.56(c) provides:

> Jurisdiction. A person may bring an action to enforce a claim under this subpart in any United States district court or in any other court of competent jurisdiction. Such claim must be brought within one year of the date on which the person's cause of action accrues. For purposes of this paragraph, a cause of action accrues as of the date on which the injured party first learns, or by which such person reasonably should have learned, of the facts and circumstances giving rise to the cause of action, including the identity of the warranting or indemnifying bank against which the action is brought.

bank may face a claim based on breach of warranty.[39] Because substitute checks will be generated by automated means, that reconverting bank will have no knowledge of this breach until it receives a claim from an indemnitee. We view this result inequitable since the drawer or issuer of the original check caused the poor image of the original check in the first instance. This inequity is underscored when the issuer is a business that reaps profits from the sale of the instrument, such as a seller of monetary instruments. While this result could be mitigated by allocating the loss between the drawer or issuer and the indemnifying banks under the comparative negligence provisions of the Act,[40] we are not confident that comparative negligence is even applicable to these claims. We believe that the better result is to have the party causing the loss, if any, to assume the loss. The illegible substitute check should enjoy legal equivalency notwithstanding the indiscernible image of the check and the indiscernible feature of the substitute check should not be the basis for having liability attach under the Act. This rule of legal equivalency as to such substitute checks would apply solely in *those* narrow circumstances where the issuer or drawer causes the creation of an illegible substitute check. Perhaps the Board can fashion a rule of preclusion similar to UCC § 3406(a) (to be introduced in Regulation CC § 229.56 or its accompanying commentary) as to customer claims in cases where the customer's conduct at the time of the issuance of the original check renders the check net subject to imaging.

F. Extension of Expedited Recredit Claim Reporting Period, If a consumer in good faith asserts a claim for recredit, the consumer may enjoy the right to an expedited recredit under Regulation CC § 229.54, provided, among other things, the consumer submits his or her claim to the paying bank by the end of the 40th calendar day after the later of the calendar day on which the bank mailed or delivered the periodic statement or made the substitute check giving rise to the claim available to the consumer.[41] A bank must extend this 40-calendar-day period by an additional reasonable amount of time due to extenuating circumstances.

[39] The Act, at § 5.
[40] The Act, *at* § 6(c).
[41] Regulation CC § 229.54(b)(1), as proposed.

Under Regulation CC § 229.55, a bank that has an indemnity claim under § 229.53 with respect to a substitute check may make an expedited recredit claim against an indemnifying bank if the claimant bank is obligated to provide an expedited recredit with respect to such check under § 229.54.

If a claimant bank is obligated to extend the 40-day period to a consumer, we seek assurance under the Proposal that an indemnifying bank cannot contend that such an extension granted by the claimant bank was unreasonable, The determination by a claimant bank to extend the reporting period should be deemed reasonable for purposes of § 229.55, and binding on the indemnifying bank. A commentary to that effect would be helpful.

In that regard, Wells Fargo suggests that a sentence substantially similar to the following be inserted in Comment 1 to Regulation § 229.55(b):

> If a claimant bank in its judgment is obligated to extend the 40-calendar-day period to a consumer due to extenuating circumstances, that granted extension shall be deemed reasonable for purposes of the claimant bank's compliance with the recrediting procedure under § 229.54.

G. **MICR Line Information Not Encoded in Magnetic Ink.** We request the final rule include a new provision that expressly authorizes a paying bank to create a legally equivalent substitute check without printing the MICR line infomation in MICR ink. We believe that a substitute check should not lose its status as the legal equivalent of the original check if the MJCR information on the check is not encoded in magnetic ink in the limited situation where the following conditions exist: (i) the reconverting bank *is* the paying bank; (ii) the paying bank has created the substitute check solely to return it to its customer with the customer's periodic statement; (iii) the information from the original check's MICR line appears on the substitute in non-MICR ink; and (iv) the reconverting bank is subject to the warranties and indemnification in Regulation CC §§ 229.52-53.

Substitute checks that are paid and canceled by the paying bank, and are to be delivered by the paying bank to its customers, do not need to be printed in MICR ink. These substitute checks will not be further processed on an automated basis, either on a forward collection or return basis. Accordingly, it is not reasonable to require a paying bank to incur the cost of using MICR ink to create this class of substitute checks. From a customer's point of view, it will not matter whether the MICR line is printed in MICR ink. Since customers do not use MICR line readers, and can visually read all the information on the substitute check, including the information contained in the MICR line, there is no detriment to customers to receiving a non-MICR ink substitute check. Indeed, a customer will not be able to tell that the substitute check lacks MICR ink.

By authorizing nonMICR ink substitute checks in the final rule, the Board will further the purposes of the *Act* to facilitate check truncation and improve the efficiency of the Nation's payments system. It is generally anticipated that it will be less expensive to print a nonMICR ink substitute check, and therefore paying banks can produce nonMICR ink substitute checks on a cost-effective basis to reach those customers who have not agreed to receive images of their checks. With this lower cost capability, paying banks will be more willing to *enter* into arrangements with other banks to exchange just check image files, instead of exchanging a mix of paper checks and check images. This will allow depositary and collecting banks to image a greater number of checks much earlier in the check collection process.

In authorizing the creation of a nonMICR ink substitute check, the final rule should clarify that an item must meet all the other requirements under the Act, the regulation, and industry standards for a substitute check in order to be deemed a "substitute check" under the Act and regulation. For example, the nonMICR ink substitute check must have the appropriate legend and be printed in accordance with industry standards as to size and paper quality. Compliance with these other requirements for a substitute check will ensure that copies of checks or check image statements are not unintentionally brought within the scope of the *Act.*

IV. Conclusion. Once again, Wells Fargo very much appreciates this opportunity to comment on the Proposal. We commend the Board and its staff for their efforts on the Proposal.

In the went of any questions concerning this letter or if Wells Fargo can be of further assistance to the Board in its consideration of thereof, please do not hesitate to contact Wells Fargo through the undersigned at 415.396.5461.

Sincerely,

Ted Teruo Kitada
Vice President & Senior Counsel